2001

First Equity Corporation v. Utah State University and Donald A. Catron : Reply Brief

Utah Supreme Court

13798

IN THE SUPREME COURT OF THE STATE OF UTAH

FIRST EQUITY CORPORATION OF FLORIDA, a Florida corporation,

Plaintiff-Appellant,

vs:

UTAH STATE UNIVERSITY, a body politic and corporate, and DONALD A. CATRON, an individual,

Defendants-Respondents.

BEAR-STEARNS & CO., HARRIS UPHAM & CO., INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., LEHMAN BROTHERS, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., SHEARSON, HAYDEN, STONE, INC., and SUTRO & CO., INC.,

Amici Curiae.

CASE NO.
13798

APPELLANT'S REPLY BRIEF

Appeal from Summary Judgment in the First Judicial District Court of Cache County, VeNoy Christofferson, District Judge, Presiding

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TABLE OF CONTENTS

INDEX OF CASES AND AUTHORITIES CITED

Constitution, Statutes and Regulations

Authorities

IN THE SUPREME COURT OF THE STATE OF UTAH

FIRST EQUITY CORPORATION OF FLORIDA, a Florida corporation, Plaintiff-Appellant, -vs- UTAH STATE UNIVERSITY, a body politic and corporate, and DONALD A. CATRON, an individual, Defendant-Respondent. BEAR-STEARNS & CO., HARRIS UPHAM & CO., INC., HORNBLOWER & WEEKS-HEMPHILL, NOYES, INC., LEHMAN BROTHERS, INC., MERRILL LYNCH, PIERCE, FENNER & SMITH, INC., SHEARSON, HAYDEN, STONE, INC. and SUTRO & CO., INC., Amici Curiae.	CASE NO. 13798

APPELLANT'S REPLY BRIEF

ARGUMENT

POINT I

USU'S CONTRACTS WITH FIRST EQUITY WERE NOT ULTRA VIRES.

Respondent's Brief in this appeal significantly misstates both the position of First Equity and certain aspects of the relevant law, and therefore requires a limited reply dealing with selected questions

1. Effect of Constitutional provisions concerning pre-existing rights and powers of USU.

USU's contention that the Territorial Legislative Act of

1888 (Comp. Laws of Utah §§1852 et seq.) could in no way have conferred general investment powers on USU is undercut by the language (cited on page 17 of the Brief prepared by counsel for the amici curiae brokers in this appeal) of the 1929 statute contained in Sec. 15, ch. 41, Laws of Utah, which clearly affirms a legislative intent to invest the University with broad, general, and independent powers to manage its financial affairs. The subsequent repeal of that statute has no effect upon its significance as legislative history and as a reflection of legislative attitude.

To maintain that broad and general powers of investment were granted is not, however, to argue that the University is totally free from the control of the Legislature. Appellant here does not make an argument "virtually identical" to the one urged by the University in University of Utah vs. Board of Examiners, 4 Utah 2d 408, 295 P.2d 348 (1956) as Respondent claims on page 14 of its Brief. In that case, the issue was whether or not the rights, "immunities, franchises and endowments" vested in the University by the Utah Constitution were to be free from the conditions and limitations placed thereon by the territorial legislature to the same effect as if no condition or limitation had been included in the territorial legislation. This Court concluded that such was not the case, but that the rights and powers perpetuated in the University were those existing prior to the adoption of the Constitution as limited by

the territorial legislation. The territorial act of 1892

> in effect declared this is the status and these are the powers of the University but they are not static, they are subject to the laws of Utah from time to time enacted. It in effect declared the University is a public corporation, but not a corporation above the Legislature. It shall always be subject to the laws of Utah.

295 P.2d at 357.

The extensive language of that case quoted by Respondent is relevant only in the context of the issues of that case, which were different from those of instant case. Respondent errs in its claim that this appeal is "plainly controlled" by the earlier decision. Respondent's use of that case is inapposite at best, since First Equity in no way espouses the position of the University of Utah that state universities are totally autonomous and outside the control of the Legislature. Rather, Appellant agrees with the Court in that case that USU is subject to the control of and limitations imposed by the legislature; Appellant argues only that such control and limitations permitted the University to invest in common stock.

More relevant to this appeal is that portion of University of Utah vs. Board of Examiners which recites the following principle of construction from 16 C.J.S., Constitutional Law §32, at 70:

> In determining the meaning of an ambiguous constitutional provision, the courts may properly seek extrinsic aid by ascertaining the construction at the time of its adoption

and since by those whose duty it has been to construe, execute, and apply it in practice.

The facts of this case upon which both parties are in agreement clearly establish that those persons whose duty it was to construe and apply the powers available to them under the total framework of Utah law believed that the University had power to invest in common stock. In addition, it is arguable that the long-standing investment practices of Utah's public universities, including the purchase and sale of common stock, are so commonly known as to warrant judicial notice being taken of them. In any case, the entire record below establishes that the Utah State Board of Regents, the USU Institutional Council, officers and employees of USU's financial management departments, and counsel at the Utah State Attorney General's Office all believed USU to be empowered to purchase common stock. Respondent points out that evidence on this question was not offered below, and argues that the Court may draw an inference from this fact that the evidence would have been unfavorable to First Equity. In the court below, First Equity took the position that the ultra vires issue was totally irrelevant since agency and estoppel doctrines in any event required a finding in its favor. On that basis, evidence concerning the pattern and practice was not relevant at that time. However, if this Court determines that the statutes in question in this appeal are ambiguous (and the opposing views taken by the parties in their briefs mights well support such a determinatior

Appellants would join amici in suggesting that the court below be instructed to consider evidence on the question on remand.

2. Interpretation of §33-1-1.

Respondent's view of 4A Utah Code Annotated ("U.C.A.") §33-1-1 as an enabling provision, despite the attempt to curcumvent the implications of its position for private entities in its Brief at page 23, must fail in light of the unambiguous language of the statute itself, heretofore cited by Appellant on pages 18-19 of its Brief. The title of S.B. 158 (Laws of Utah, 1939) enacting §33-1-1 is, in this case, irrelevant according to Respondent's cited canon of construction since the statute is in no way ambiguous: it says quite clearly that the described entities may lawfully invest in the described securities. The entities so described include "private, political, or public" instrumentalities, bodies, corporations and persons. The fact that the statutory title does not mention private entities, as pointed out by Respondent, is not of earthshaking significance, since the title also fails to mention a number of other classes of potential investors whose coverage by the statute Respondent is unlikely to challenge, for example: receivers, municipalities, a state insurance fund, state sinking fund, or state school fund, and any board, commission or officer of the state government. Thus, Respondent's attempt to avoid the extreme and untenable implications of its interpretation of §33-1-1 is unconvincing. Appellant reemphasizes

the language of the statute itself is controlling and that language contemplates already existing powers to invest funds. If new powers of investment theretofore non-existent were intended to be brought into being by §33-1-1, the canons of statutory construction urged upon this Court by Respondent, at pages 18-22 of Respondents Brief, would certainly require a clear and affirmative grant of such powers. Section 33-1-1 not only contains no language which could be so construed, but also it does contain language which contradicts that interpretation. Respondent's position requires the absurd conclusion that, prior to the enactment of §33-1-1, USU had no power to invest in anything, nor did any of the entities described in that section. Such a conclusion flies in the face of common sense and the extensive legislative history and statutory language before this Court.

POINT II

EVEN IF USU HAD NO AUTHORITY TO PURCHASE COMMON STOCK, IT HAD AUTHORITY TO CONTRACT FOR FIRST EQUITY'S SERVICES, AND IS LIABLE ON THOSE CONTRACTS FOR THE VALUE OF THOSE SERVICES.

USU states that First Equity should not be allowed to argue before this Court that it was USU's agent because it did not raise the argument in the court below. See Respondent's Brief at page 44. The authorities cited by USU to support its statement are clearly distinguishable from this case.

Pettingill v. Perkins, 2 Utah 2d 266, 272 P.2d 185 (1954), involved an appellant who sought to have the decision below reversed

because he had asked the court to give erroneous instructions to the jury. No objection to the instructions had been raised, but on the basis of appellant's instructions, the jury had found against him. This Court determined that the appellant could not assign as error the giving of his own instructions. In Davis v. Mulholland, 25 Utah 2d 56, 475 P.2d 834 (1970), the appellant had tried his contract rescission claim on the theory that there had been a mutual mistake of fact. On appeal from the judgment against him, the appellant argued for reversal on the theory that there had been a unilateral mistake of fact. This Court stated:

> Ordinarily an appellant cannot change his theory of the case on appeal from that presented to the court below.

475 P.2d at 834.

First Equity does not now seek to reverse on the basis of its own errors below, nor has First Equity changed its theory on appeal. First Equity claimed in its Complaint that it was a registered securities broker and that it had entered into agreements with USU to purchase securities for USU. The confirmations of the transactions, copies of which are attached to the Complaint, each state: "AS BROKER, WE HAVE PURCHASED FOR YOUR ACCOUNT." It is perfectly clear that the fact of First Equity's agency, as broker, was before the court below. Furthermore, Appellant does not and has not changed its theory on appeal. First Equity continues to assert that it was the authorized agent of USU and that, as such, it is entitled to

compensation for its services and to be indemnified for losses it suffered in performing, at USU's request, acts which were not manifestly illegal and which it had no knowledge were illegal (if in fact they were illegal, which First Equity also disputes). Finally, USU itself raised the question of whether or not a triable issue of fact is present with respect to the amount of individual grant monies that were available for investment in common stock. The court below ruled in USU's favor on that question and First Equity has merely emphasized the agency relationship to point out the error of the lower court's decision. This Court has no legal basis to ignore Appellant's argument as USU suggests.

In further response to Respondent's suggestion that this Court disregard First Equity's arguments on this question, the following language is cited:

> The rule requiring adherence to the theory relied on below does not mean that the parties are limited in the appellate court to the same reasons or arguments advanced in the lower court upon the matter or question in issue [citations omitted].

5 Am Jur 2d, Appeal & Error §546.

The question in issue before the lower court and before this Court is USU's liability to First Equity for broker's commissions and losses. First Equity has simply offered on appeal an additional reason and argument for such liability; the argument is properly made.

USU argues on page 44 of its Brief that First Equity was the "other party to five contracts with USU whereby USU was to pay it commissions for its services."

USU attempts to counter First Equity's agency analysis with the point that "a broker often acts as the agent of the seller as well as the buyer," at page 45 of its Brief. First Equity acknowledges the accuracy of this observation, but alleges that, on the factual record in this case, it is beside the point, since First Equity was USU's agent in each of the transactions sued upon below. USU may not "concede" the point (Respondent's Brief at page 45) but there is clearly evidence showing this to be the case. Attached as Exhibits to Plaintiff's Complaint in this case are the confirmations of USU's unsolicited orders, each of which bears the notation, in large black type, "AS BROKER, WE HAVE PURCHASED FOR YOUR ACCOUNT." In the absence of any evidence to the contrary (which evidence would of course have been within USU's power to produce below), this Court and USU are bound by the language of the confirmations contained as part of the Record here. 7B U.C.A. §70A-8-319(c).

USU then makes the surprising argument, unsupported by references to either the record or to authority that "those contracts were ultra vires", and "are as unenforceable as any other ultra vires contract for the performance of services." Appellant submits that there is nothing in the record to indicate that USU had no power to contract

with a broker for its services. Brokers have been known to deal in most of the "lawful" securities described in §33-1-1, and Respondent clearly could not argue that a contract with a broker to purchase that type of security would be ultra vires. The brokerage contract is of course the same, notwithstanding the type of securities purchased. USU is confusing what were in actuality two separate series of contractual transactions - one whereby it purchased and/or sold stock to or from a third party, and another whereby it employed First Equity to execute the first series of transactions as USU's agent, in return for which services it promised to pay a fee. Since contracting for brokerage services is clearly within the proper powers of USU, the argument that the contracts between USU and First Equity are unenforceable because they were ultra vires is untenable.

With respect to Respondent's argument that First Equity, and not a third party, should bear the losses suffered in this case, Appellant observes both that the above analysis of USU's contractual liability makes that argument superflous and second, that the cases Respondent cites as supporting its position are inapposite. For example, in Hirning v. Federal Reserve Bank of Minneapolis, 52 F.2d 382 (8th Cir., 1931) cited on page 46 of Respondent's Brief, the defendant agent was an agent for third parties, which third parties received illegal preferential transfers via the agent bank's actions. In contrast to an injured party not agent or principal in Hirning, i.e.

the insolvent bank entitled to return of preferential transfers for proper distribution by the receiver, the instant case presents us with the quite distinct circumstance of a principal attempting to renegue on its contractual obligations to an agent on the grounds that it had no power to order the agent to buy and sell certain types of securities, even though it clearly did have power to agree to compensate the agent for services rendered.

Inland Waterways v. Hardee, 100 F.2d 678, (D.C. Cir., 1938), rev'd on other grounds, 309 U.S. 517, cited on page 47 of USU's Brief, also involved a totally distinct factual situation. It was a suit by the receiver of the insolvent Commercial National Bank of Washington City against Inland Waterways Corp., the U.S. Shipping Board Merchant Fleet Corporation, and several other parties. The Merchant Fleet Corporation deposited funds belonging to its principal, (the United States government) with Commercial National Bank. It extracted from the Bank an illegal pledge of Bank assets (U.S. Bonds) to secure that deposit. Subsequent to the Bank's insolvency the bonds had been sold and the Fleet Corporation had returned the funds to the U.S. Treasury. The Court, in explaining its decision that the Fleet Corporation must make good the proceeds of the bond sale to the insolvent Bank, said:

> The question, as we think, does not depend upon the ability of the receiver to trace the funds which the Corporation received from the assets of the bank, but is controlled by the rule that one who participates

> in a breach of trust may be required either to account for the proceeds or respond in damages . . . . In this case the corporation deposited funds under its control in a national bank and received from the bank . . . security . . . . The pledge was unlawful . . . . When the Corporation demanded and received and used the pledged security, ... a conversion of trust property ensued. [emphasis added]

100 F.2d 678.

Once again, the agent in the above case represented a third party principal not a plaintiff, and the injured party had suffered loss because of the agent. The agent itself had caused injury by a "breach of trust" and a "conversion" of trust property, as the emphasized portions above indicate. These facts in no way comport with those of this case, in which the principal seeks to avoid and to shift to its agent losses incurred because of its own acts and not by any wrongdoing or illegal act of its agent. In addition, the equitable considerations clearly uppermost in the minds of the Courts deciding the above cases have no application to the case at bar.

POINT III

THE COURT ERRED IN DENYING FIRST EQUITY'S MOTION FOR SUMMARY JUDGMENT BECAUSE A TECHNICAL VIOLATION OF THE 35-DAY MARGIN REQUIREMENT OF REGULATION T DOES NOT CONSTITUTE A COMPLETE DEFENSE TO FIRST EQUITY'S CLAIM FOR DAMAGES.

1. Court Interpretation.

USU's unblushing conclusion to its abbreviated discussion of the case law dealing with the effect of a violation of Section 7

of the Securities Exchange Act of 1934 (the "Exchange Act") is as follows:

> Judge Christofferson was eminently correct in following Avery in holding Regulation T to provide a complete and not just a partial defense.

Respondent's Brief, at 56.

First Equity agrees that the decision below was notable, but not for its correctness. Indeed, USU does not explain why it is able to conclude that the decision in Avery v. Merrill, Lynch, Pierce, Fenner & Smith, 328 F. Supp. 677 (D.D.C. 1971), was a worthy example to follow. The Avery decision was not in harmony with United States Supreme Court interpretation of the Exchange Act. See Mills v. Electric Auto-Lite Co., 396 U.S. 375 (1970). The grim result in Avery did not correspond to the equitable result in Pearlstein v. Scudder & German, 429 F.2d 1136 (2d Cir. 1970), the case upon which the judge in Avery seemed to rely. The Avery judge also claimed to rely upon the unequivocal mandate of Congress and strong public policy considerations placing the burden of compliance solely upon brokers. 328 F. Supp. at 681. But in 1971 Congress amended the Exchange Act to place the burden of compliance upon customers as well as brokers. See Section 7(f) of the Exchange Act; Regulation X, 12 C.F.R. Part 224 (1975). Following that amendment, courts have begun to deny customers the recovery of damages from brokers in implied civil actions based upon unforeseen violations of Regulation T. See State

of Utah v. Merrill, Lynch, Pierce, Fenner & Smith, Inc. Civil No. NC 74-46, Memorandum Opinion and Order (D. Utah, July 8, 1975); Newman v. Pershing & Co., Inc., [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶95,060 (S.D.N.Y. April 14, 1975); Bell v. J.D. Winer & Co., Inc., [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶95,002 (S.D.N.Y. Mar. 5, 1975).

USU makes the following representation as to the law on Regulation T at page 50 of its Brief:

> It is settled that a customer may recover damages from a broker in a civil lawsuit for violating Regulation T and, a fortiori, that a customer may lawfully resist payment he would otherwise be obligated to make where the broker has violated Regulation T.

In light of the enactments of Congress and the decisions of the federal courts, cited herein and in Appellant's Brief at 42, and in light of the decisions of the state appellate courts, such as DuPont, Glore, Forgan, Inc. v. Mariash, 75 Misc. 2d 450, 347 N.Y.S. 2d 886 (1st Dept. 1973) and others cited in Appellant's Brief at pages 46-47, USU's representation is seen clearly as an abbreviated and unedifying misstatement of the law. The decision below, which upholds USU's simplistic representation, is "eminently" incorrect.

2. Violation of a Contract of Adhesion.

As an alternative Regulation T defense, Respondent claims that it is excused from paying First Equity because, in not making delivery within the 35-day margin requirement, Appellant breached

the contracts of adhesion it imposed upon USU. Respondent fails to support this claim with any pertinent facts, or statutory or case law.

The crux of USU's argument is that the confirmations sent to USU to evidence the oral purchase agreements were contracts of adhesion. In support of that position, USU alleges that (1) the confirmations were prepared by First Equity, (2) the language is "stock language", and (3) no negotiations occurred with respect to that language. Such allegations, even if true, do not constitute overreaching and unconscionability such as is necessary to find a contract of adhesion.

Someone has to prepare a written memorandum of an oral contract if a written record is to be kept and, under the conditions existing in the securities industry, it is less burdensome for the broker to prepare all such memoranda than for the broker to rely upon its customers to draft such documents. The applicable statute of frauds, Section 8-319(c) of the Uniform Commercial Code, 7B U.C.A. §70A-8-319(c), recognizes this practice and states:

> A contract for the sale of securities is not enforceable by way of action or defense unless
> . . .
> within a reasonable time a writing in confirmation of the sale or purchase and sufficient against the sender under paragraph (a) has been received by the party against whom enforcement is sought and he has failed to send written objection to its contents within ten days after its receipt . . . .

The Draftsmen's Comment to this provision states:

> Paragraph (c) is particularly important in the relationship of broker and customer. Normally a great volume of such business is done over the telephone. Orders are executed almost immediately and confirmed on the same or the next business day, usually on standard forms which as to the broker more than meet the minimal requirements of paragraph (a). It is reasonable to require the customer to raise his objection, if any, within ten days after the confirmation has been received . . . .

Draftsmen's Comment 2., [Current Materials Vol.2] UCC REP. SERV. ¶8319.

The practicalities of preparing these confirmations imposes upon the broker the necessity of using a standard form with "stock language" that is not negotiated with the customer. Furthermore, it would make no sense to negotiate the language which supposedly bothers USU because the language simply draws to the attention of the customer matters (1) which are required by law to be disclosed, or (2) which are a part of the law applicable to the transaction and part of the contract whether stated or not. Great Northern R. Co. v. Sunburst Oil & Ref. Co., 287 U.S. 358 (1932); Swenson v. File, 90 Cal. Rptr. 580, 475 P.2d 852 (1970); Yeazell v. Copins, 98 Ariz. 109, 402 P.2d 541 (1965).

Brokers realize that many of their investors are not sophisticated and that such investors are not aware of the complex regulatory framework in which securities transactions take place. Thus, most

of the terms set forth on the confirmations seek to inform the investor of the laws applicable to the transaction, thereby reducing much of the potential for needless controversy which an oral contract often carries with it.

In addition to the functional necessity for brokers to preapre confirmations, Rule 17a-3(a)(6) of the Securities and Exchange Commission ("SEC") requires registered brokers to maintain a record of each brokerage order. See 17 C.F.R. §240.17a-3(a)(6). The same Rule requires that the memorandum of each brokerage order

> . . . shall show the terms and conditions of the order or instructions and of any modification or cancellation thereof, the account for which entered, the time of entry, the price at which executed and, to the extent feasible, the time of execution or cancellation.

Thus, each of First Equity's confirmations contains on its face the necessary information and instructions, and then states: "We confirm this transaction subject to agreement on the reverse side." Record at pages 111-149. The reverse side contains the terms and conditions affecting cash account brokerage orders under the bold heading "CONDITIONS." Record at page 272.

The first condition informs the investor of the provisions of U.C.C. Section 8-319(c), stating: "It is agreed that . . . [y]ou will report any errors immediately and/or notify us if not entirely in accordance with your understanding." This provisions calls to the customers attention

the fact that the contract may be altered if the confirmation slip is not entirely in accordance with his understanding. The changes are to be reported immediately because, after ten days, U.C.C. Section 8-319(c) makes the confirmation binding upon the parties. See Anderson v. Francis I. DuPont & Co., 9 UCC REP. SERV. 500 (Fla. Dist. Ct. App. July 20, 1971); Weiss v. Dempsey-Tegeler & Co., 443 S.W. 2d 934 (Tex. Ct. Civ. App. 1969).

The second condition, which is expressly applicable to this appeal, states in relevant part: "It is agreed that . . . [a]ll transactions are subject to the rules, regulations, requirements (including margin requirements) and customs of the Federal Reserve Board . . . ." This statement is clearly not negotiable because such rules and regulations would apply whether or not the foregoing language was expressly agreed to. Applicable law and regulation again have been drawn to the customer's attention.

The third paragraph of conditions, dealing with the hypothecation of securities, draws to the customer's attention the provisions of SEC Rule 8c-1(c), 17 C.F.R. §240.18-1(c). The last paragraph of conditions deals in part with disclosures that the National Association of Securities Dealers ("N.A.S.D") requires its members to make. See N.A.S.D. Rules of Fair Practice, Art. III, §12, CCH N.A.S.D. MANUAL ¶2162. Also the last paragraph of conditions deals in part with the broker's rights upon the customer's failure to make payment by the settlement date, which rights are a matter of law. See

Baldwin v. Peters, Writer & Christensen, 141 Colo. 529, 349 P.2d 146 (1960); Mass v. Gordon, 101 So.2d 836 (Fla. App. 1958); Rosenstock v. Tormey, 32 Md. 169 (1870). These conditions were simply matters of law and regulations, some of which were required to be disclosed, which governed the transactions. Therefore, the claim that this "stock language" was not negotiated between the parties makes no sense. The laws referred to in such "stock language" applied to the transactions whether or not they were mentioned in the confirmations.

Based upon the foregoing discussion and authorities, it is clearly improper to characterize these confirmations as contracts of adhesion. They are not cunningly devised contracts drafted by a powerful commercial unit and imposed upon an individual on an "accept this or get nothing" basis. See 6A CORBIN ON CONTRACTS Section 1376 (1960). There is no overreaching, no unconscionable imposition of liability, no attempt to so restrict the customer as to leave no avenue of escape. See New Prague Flouring Mill Co. v. Spears, 194 Iowa 417, 189 N.W. 815 (1922). The confirmation slips are not contracts of adhesion.

The second major flaw in Respondent's defense is that USU alleges that a failure to deliver the securities within 35 days constituted a sufficient breach of the contract to allow USU to rescind and incur no liability. The 35-day limit is not specified in the confirmations, nor is any right to rescind specified. USU relies solely on the provision that calls the customer's attention to the fact that the contract is subject to the "margin requirements"

of the Federal Reserve Board. Those margin requirements, as construed by the courts, include much more than the 35-day limit provided by Regulation T. For example, Regulation X of the margin requirements placed the responsibility upon USU not to allow its purchases through First Equity to take longer than 35 days. It is clear that USU has voluntarily breached that provision; USU utilized First Equity because of the delays inherent in receiving stock certificates from a Florida brokerage house. Deposition of Catron at pages 118-19, 218-21.

It has been judicially recognized that a strict construction of the margin requirements in favor of customers and against brokers extends the protection of the laws to a point where the purposes of the securities laws are impeded. Newman v. Pershing & Co., Inc., [1974-1975 Transfer Binder] CCH FED. SEC. L. REP. ¶95,060 (S.D.N.Y. April 4, 1975). A strict construction against brokers may tend to encourage customers to do as USU has done, to wit: (1) to utilize a broker who may perform the contracts in violation of Regulation T due to de minimus, unforeseeable human error, and (2) to then seek to place all the risk and liability of the transaction on the broker. Thus, a strict construction such as USU contends is necessary in this case encourages unlawful behavior rather than discouraging it.

Furthermore, in construing the language of the confirmations, the Court is required to bear in mind the situation of the parties and the subject matter of the contract. In preparing the confirmation

the broker is not required to state anything about laws or regulations applicable to the transaction, except for the limited disclosure required by Article III, Section 12 of the N.A.S.D. Rules of Fair Practice discussed previously. The broker does not have to inform his customer of the legal consequences that may flow from the transaction, but if he does not, the customer could embroil the broker in needless controversies, needless court actions could be instituted, or the customer could continue to invest in an uninformed manner. If the broker exercises his discretion to inform his customer of the applicable laws, rules, and regulations, then, according to the interpretation of the confirmations that USU puts forward, the broker should be held strictly accountable for any alleged ambiguity in the confirmations. Such a rule would serve to discourage brokers from educating their customers and to encourage needless controversy.

Finally, this Court cannot simply rely upon what USU erroneously refers to as "an accepted canon of statutory construction." Respondent's Brief at 57. That canon of construction can only come into play if there is an ambiguity in the contract and there is no ambiguity here. The contract refers to the margin requirements of the Federal Reserve Board and they are, of course, spelled out in the applicable laws and regulations. Such laws and regulations, as interpreted by the courts, do not include the right to rescind a brokerage contract for a de minimus violation resulting from human error, particularly when

the party seeking to rescind is the party which encouraged the violation. Moreover, even if there is an ambiguity, which First Equity emphatically denies, there is another accepted canon of construction which requires that comparatively unimportant matters which may be severed from the agreement without impairing its effect or changing its character, such as an educational reference to the applicable law, must be suppressed if in that way and only that way the agreement can be sustained and enforced. Rhoades v. Chesapeake & O.R. Co., 49 W. Va. 494, 39 S.E. 209 (1901). Needless to say, a battle of canons, such as USU's Brief encourages, would only obfuscate the real issues. A broker simply is not required by law to insure its customer against all losses attendant to investing through a margin account.

POINT IV

FIRST EQUITY HAD NO CONSTRUCTIVE NOTICE OF ANY WITHDRAWAL OF CATRON'S AUTHORITY BECAUSE THE COLLECTING BANKS WERE NOT FIRST EQUITY'S AGENTS.

Judge Christofferson concluded his memorandum decision by stating:

> In view of the above rulings, the court feels that it is unnecessary to comment on further defenses of Utah State, such as the First Security and Walker Bank and Trust Company being agents of the plaintiff and their knowledge that Catron had no authority to purchase common stock as a defense. The court feels that both have merit, but has indicated in view of the previous rulings the court feels further comment is unnecessary . . . .

Record at page 259.

The question of whether the banks were First Equity's agents is governed by the provisions of the Uniform Commericial Code, as Respondent has pointed out in its Brief, pages 59 and 60. Therein Respondent noted that 7B U.C.A. Section 70A-4-104(1)(g), provides:

> "Item" means any instrument for the payment of money even though it is not negotiable but does not include money.

Respondent also drew attention to the fact that 7B U.C.A. Section 70A-4-105(d) states:

> "Collecting bank" means any bank handling the item for collection except the payor bank.

Additionally, Respondent relied upon a somewhat analagous case, Phelan v. University Nat'l Bank, 85 Ill. App. 2d 56, 229 N.E. 2d 374 (1967), in which it was held that the stock broker could not recover from the bank for failure to pay for the securities because the bank was a "collecting bank" and not a "payor bank."

Finally, Respondent cites 7B U.C.A. Section 70A-4-201(1), which provides:

> Unless a contrary intent clearly appears and prior to the time that a settlement given by a collecting bank for an item is or becomes final, the bank is an agent or subagent of the owner of the item . . . .

On that basis, USU claims that the banks involved in this case were the agents of First Equity and, therefore, First Equity is chargeable with whatever notice the bank officers received from reading news items that appeared in newspapers on December 15, 1973.

Record, at pages 326-27, 337-39. However, neither of the banks was acting as a collecting bank at that time. Record, at pages 99-149, 160-62; Deposition, at pages 80-81.

There are other clear reasons why the presumption of agency stated in Section 70A-4-201(1) should be disregarded in this case. First, the presumption was established for the purpose of settling the nature of the depositor-bank relationship in a situation where the collecting bank is being sued by the owner of the item that is deposited for collection. See Draftsmen's Comments 1 and 2, [Current Materials Vol.2] UCC REP. SERV. ¶4201. That purpose was well served in the Phelan case where the bank was named as a defendant, but there is no defendant bank here. Thus, the entire purpose for the presumption fails in this case.

Furthermore, it is not true, as USU states, that Phelan involved "a factual situtation identical" to the one in this case. Respondent' Brief at page 60. The court in Phelan stated that the broker-dealer in that case had sold common stock to the investor, implying certainly that it was a "principal" transaction rather than a "broker" transaction . In this case the broker purchased common stock for the investor. First Equity was not the owner of the securities, but simply acted as agent for USU in obtaining the securities and forwarding them to USU's designated banks. USU is also incorrect when it states that the "paper work involved in the instant case is even

identical to that in Phelan." Respondent's Brief at page 61. The transmittal letter to the defendant bank in Phelan stated: "We enclose for collection and remittance in Chicago funds only when actually paid." (Emphasis added). The instruction letter to First Security Bank simply states: "For delivery to a/c Utah State University against payment of draft attached ($67,019.00). Please credit our account WITH FEDERAL RESERVE BANK IN JACKSONVILLE FLORIDA THRU WIRE ADVICE ATTENTION of the undersigned." (Emphasis added). (Record, at page 307). Thus, the function of each bank in this case was primarily one of receipt of stock certificates for USU, its account-holder. USU directed which bank should be used by First Equity for that purpose and the bank primarily accepted delivery for USU and paid out its account-holder's funds to First Equity. In such a situation, it may be true that the banks are formally designated as collecting banks, but the presunption of agency should clearly be set aside. First Equity, acting as purchasing agent for USU, simply transferred securities to the banks, acting as receiving agents of USU. The banks were not First Equity's agents.

CONCLUSION

Respondent's argument that the lower court decision denying First Equity's Motion for Summary Judgment should be upheld because "other defenses" were available to USU is totally outside the scope of this appeal. Since the lower court did not rule on these matters (discussed at pages 65-72 of Respondent's Brief), the questions have

not been presented for appeal, and Respondent's arguments are not properly before this Court.

In conclusion, Appellant urges that the orders of the lower court be reversed, and the case be remanded for trial on the issues which require further evidence.

Respectfully submitted,

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CERTIFICATE OF SERVICE

I hereby certify that I delivered a true and exact copy of the foregoing Appellant's Reply Brief to David L. Wilkinson, Office of the Attorney General, Utah State Capitol Building, Salt Lake City, Utah 84111, Keith Taylor, Parsons, Behle & Latimer, 79 South State, Salt Lake City, Utah 84111; and Harold Christensen, Worsley, Snow & Christensen, Continental Bank Building, Salt Lake City, Utah 84101, on this 10th day of September, 1975.

/s/ Mary Janet M. Johnson